
IRS amendments clarify and correct FATCA regulations: Do any of the changes affect your compliance plan?

September 19, 2013

In brief

The Internal Revenue Service (IRS) on September 10 issued [correcting amendments](#) to the final Foreign Account Tax Compliance Act (FATCA) regulations released in January. The amendments clarify and correct various provisions and according to the release, their purpose is three-fold: (i) correct several citations and cross references, (ii) modify the regulatory language to clarify the relevant provisions to meet their intended purposes; and (iii) ensure that the rules in the final FATCA regulations are coordinated with rules in other relevant regulations, such as those under Chapters 3 and 61 of the Internal Revenue Code.

These amendments should be read in context with the current regulations. According to the release, the effective date of the corrections is September 10, the date of publication in the federal register. The release also references an applicability date as of January 28, 2013. From a practical perspective, these corrections should be viewed as if they were promulgated at the time the final regulations were released.

As is typical, many of the correcting amendments are grammatical in nature. However, some clarifications are more technical – they either formally ‘connect the dots’ in the regulatory language or make minor substantive changes to the rules themselves. As a result, the corrections should be reviewed by stakeholders to determine their impact, if at all, on their compliance plan and previously completed analyses.

In detail

Specific clarifications

The following is a partial list of the corrections:

Branches

Definition of a branch

Under the final regulations, a unit, business, or office of a foreign financial institution (FFI) qualified as a branch for

FATCA purposes if it met two requirements. First, it must be treated as a branch under the regulatory regime of the country in which it is located or is otherwise regulated under the laws of such country as separate from other offices, units, or branches of the FFI. Second, it must maintain a separate set of books and records, i.e., separate

from the books and records of other branches of the FFI.

The amendments, however, simplify the definition of a branch by eliminating the need to maintain separate books and records. Thus, treatment as a branch in the local jurisdiction (or other separate treatment under local law or regulations) is now the only requirement for

for an entity to qualify as a branch for FATCA purposes.

Observation: *The policy of deferring to local law has been a consistent theme in the FATCA regime in order to minimize the confusion and potential inconsistencies between US tax concepts and local law. However, this change may have little practical effect depending upon the facts. If an entity has a branch recognized by the local jurisdiction, it would likely be a taxpayer and thus there may be a practical need for maintaining separate books and records in order to file tax returns.*

Qualification as a limited branch

The final regulations provide a specific definition of a limited branch. Under this definition, the law of the jurisdiction of the FFI (of which the branch is a part) had to restrict compliance with certain conditions in the FATCA regulations as of February 15, 2012. In other words, the branch must have faced a local law barrier to its FATCA compliance as of February 15, 2012 in order to qualify as a limited branch. The amendments remove this date restriction.

Observation: *A local law restriction can be enacted at any time causing the entity to be a limited branch. From a practical perspective, this clarification enables additional branches to potentially qualify as limited branches prior to 2016 (at which time the provisions providing for a limited branch or a limited FFI sunset). Note that this change adds the requirement to monitor local law changes.*

Documentation retention period for branches

The final regulations require an FFI with one or more limited branches to keep records of account holder

documentation for six years from the effective date of the applicable FFI Agreement. The amendments clarify that they must maintain the records (account holder and payee documentation) for the longer of six years from the effective date of the FFI Agreement or for as long as the branch maintains the account or obligation.

Observation: *As a practical matter, extending the amount of time branches have to maintain records of account documentation may increase FATCA compliance burdens as systems must ensure that this alternative is taken into account.*

Inclusive treatment of US branches of Model 1 FFIs

Under the final regulations, US branches of participating FFIs (PFFIs) treated as US persons apply the same documentation standards as US withholding agents (USWAs). In addition, if they follow the backup withholding and reporting rules that apply to USWAs, they are deemed FATCA compliant. The final regulations were silent regarding the treatment of US branches of Model 1 FFIs. The amendments extend this treatment to such entities by expressly referencing 'reporting Model 1 FFIs' in this provision.

Documentation

Form W-8 indefinite validity provisions

The final regulations provide that certain Forms W-8, *Certificate of Foreign Status*, would be valid indefinitely if accompanied by documentary evidence and there are no specified US indicia present. However, from the reading of the regulations, it was somewhat unclear whether the documentary evidence had to be refreshed every three years. The amendments clarify that there is

no need to refresh the documentary evidence so long as the Form W-8 and documentary evidence were provided together at the same time.

Observation: *This change benefits both sides of a payment transaction – individuals and entities (including FFIs) that are required to provide the Form W-8 under FATCA, as well as withholding agents.*

Changes in circumstances when identifying account holders and payees

Under the regulations, where there is a change in circumstances that affects the Chapter 4 status of a payee, a PFFI is required to treat the payee as recalcitrant or as an NPFFI (as the case may be) and begin withholding upon the earlier of 90-days or at the time of the first withholdable payment to the account following the change in circumstances. In contrast, a withholding agent is permitted to treat the payee as having the same Chapter 4 status for a period of 90 days before it must begin withholding. The amendments harmonize the rules for PFFIs and withholding agents where there is a change of circumstances. Under the amendments, the PFFI is now also permitted to treat a payee as having the same Chapter 4 status for 90 days, before it must begin withholding (i.e., only the 90-day rule applies.)

Observation: *The amendments ensure that PFFIs will get to take advantage of the full 90-day grace period following a change in circumstances. Note that the change in circumstances provisions that apply to other situations (e.g., where preexisting account dollar thresholds are exceeded) have not been changed.*

Sponsoring relationships

Requirements to be a sponsoring entity

The final regulations provided that a sponsoring entity must have management authority over the sponsored entity and be authorized to enter into contracts on its behalf in order to assume its FATCA compliance. The amendments eliminate these requirements and clarify that the sponsoring entity only needs to be authorized to act on behalf of the FFI to fulfill the requirements of the FFI Agreement. Overall management or contracting authority is no longer required.

Observation: *This change eliminates a potential hurdle for pursuing a sponsoring relationship. It is also a welcome change as the authority to enter into contracts for another entity can be an element for a tax authority to argue that a permanent establishment has been created for local income tax purposes.*

Definition of a financial institution

Investment entities

The final regulations provide examples illustrating a number of circumstances under which an entity would fit within the definition of a financial institution. In one highly debated example, a fund manager hires a foreign investment advisor (that primarily conducts business of providing investment advice) to provide advice regarding the financial assets in which the fund invests. The corrections makes changes to this example such that the investment advisor now provides discretionary management of a portion of the financial assets held by the fund and that the investment advisor primarily conducts a business of managing financial assets, not simply providing investment advice.

Observation: *This new language appears to limit the extent to which investment advisors are included in the definition of an FFI. For example, those investment advisors providing more ad hoc investment advice may not fall under this example versus those providing discretionary management with respect to some of the investment assets of the fund manager.*

Excepted nonfinancial groups

The final regulations provide an exception from the definition of a financial institution for certain nonfinancial groups. An expanded affiliated group (EAG) may be a nonfinancial group by meeting certain requirements, including a three-year 25% gross income test. Under this test, the regulations provide that income derived by certain members (e.g., those in liquidation or bankruptcy) is excluded. The correcting amendments add that income derived from transactions between members of an EAG should also be excluded.

Observation: *This change may be helpful because it could potentially exclude certain entities from qualifying as a financial institution under FATCA. For example, depending upon the circumstances, this correction could apply where there is intercompany debt between members of the EAG.*

More guidance to come

The correcting amendments do not reflect the push-back of FATCA compliance dates as provided in Notice 2013-43. (See previous [*Global IRW Newsbrief: US government announces six month extension to FATCA effective dates*](#)). Guidance will need to be released so that the regulations accurately reflect the new timeline. However, the IRS has not officially stated how this will be done.

Observation: *The Treasury and IRS have many more guidance documents to complete and release including forms (W-8, 1042 etc.), FFI Agreements, additional intergovernmental agreements (IGAs), etc. It appears that three pieces of additional regulatory guidance from the IRS may be forthcoming:*

- *amended regulations that reflect the proper dates pronounced in Notice 2013-43 and any additional substantive modifications*
- *detailed guidance to coordinate Chapters 3 and 61 with Chapter 4 (FATCA), to reduce or eliminate duplicative reporting, and to conform withholding, payee identification, and other due diligence rules of Chapters 3 and 61 to Chapter 4.*
- *additional regulations that will include substantive changes to the regulations addressing those areas that the IRS has previously indicated (e.g., passthru payments, gross proceeds, external audits for qualified intermediaries and private arrangement intermediaries.)*

The takeaway

The amendments to the final regulations provide clarifications to many areas of FATCA compliance. Stakeholders should determine if the amendments have any impact on their compliance plans or previously completed analyses. As an example, if limited branches have already been identified, there may be a need to further analyze whether subsequent changes to local law impact such identification. Does the clarification around sponsoring entities and their need to have a less than previously understood amount of authority over sponsored entities simplify the decision to be a sponsored or

sponsoring FFI? May specific entities within an EAG now meet the three-year 25% gross income test to qualify as an excepted nonfinancial group?

Companies should expect that the additional regulatory releases by the IRS and the promulgation of more IGAs may also impact their

compliance plans. As a result, they should remain flexible and understand that regular reassessments will likely need to occur as new guidance is released. Compliance efforts continue to be focused around the upcoming January 1, 2014 official start of FATCA

registration, as well as the July 1, 2014 start of FATCA withholding. However, companies should consider various other related issues including FATCA's impact on tax operations, internal controls, and legal entity management.

Let's talk

For more information on how FATCA and other information requirements might impact your organization, please contact a member of the PwC **Global Information Reporting Network**. To view FATCA contacts for more than 50 countries worldwide, click [here](#).

Additional background

- Access to the FATCA registration system and related support information can be found on the [IRS FATCA page](#).
- Additional FATCA information can be found on the US Treasury [FATCA Resource Center](#).
- To download a formatted version of the regulations incorporating the changes in the correcting amendments, [click here](#).
- For additional thought leadership regarding FATCA guidance and implementation, please see our [FATCA Publications archive](#).
- To keep up-to-date with the release of the FATCA IGAs and some of their unique differences, please see our [FATCA IGA Monitor website](#) that includes:
 - a high-level overview of signed IGAs
 - the latest IGA developments
 - potential actions to think about as you look at the impact of the IGAs to your FATCA program.